REASONABLE RATES.

STATES may fix local rates for public service, but decisions of the United States Supreme Court have swept away the power of states to make their rates conclusive.

This result has been reached gradually through a line of decisions under the Fourteenth Amendment.

In the earliest cases of rate regulation under the amendment the court declined to review the reasonableness of rates fixed by states, holding this to be purely a legislative question. Later the court decided to review the extent of rate regulation, but held that rates which permitted some, though only a slight, return on the property devoted to a public service were legal. Finally a position has been reached where rates fixed by states are held invalid unless they permit as large profits as the court thinks the public service ought to yield. In this way the power to determine what are reasonable rates for public service has been transferred from state legislatures to the Supreme Court.

The first case in which the extent of state regulation of rates for public service was brought before the Supreme Court for review, after adoption of the Fourteenth Amendment, was Munn *vs.* Illinois,[1] decided in 1876. This case involved the validity of an Illinois statute that fixed a maximum rate for storing grain in elevators at Chicago. Munn, having been convicted and fined in the state courts for violation of the statute, appealed to the United States courts on the ground that enforcement of the rate provided by the statute would take his property without due process of law and violate the Fourteenth Amendment. In the course of an opinion upholding the validity of the statute, Chief Justice Waite said, speaking for the court:

> It is insisted, however, that the owner of property is entitled to a reasonable compensation for its use, even though it be clothed with a public interest, and that what is reasonable is a judicial and not a legislative question.
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> As has already been shown, the practice has been otherwise. In countries where the common law prevails, it has been customary from time immemorial for the legislature to declare what shall be reasonable compensation under such circumstances, or, perhaps more properly speaking to fix a maximum

[1] 94 U. S. 113.

beyond which any charge made would be unreasonable. . . . . The controlling fact is the power to regulate at all. If that exists, the right to establish the maximum of charge, as one of the means of regulation, is implied.

From these statements it is perfectly clear that the question as to the right of those engaged in a public calling to have a judicial review of rates fixed by a legislature was squarely presented to the court in this case. It is equally clear that in the opinion of the court no such right existed.

Of the nine Supreme Court Justices, two, Field and Strong, dissented from the decision in Munn *vs.* Illinois. The dissenting opinion was prepared by Justice Field and concurred in by Justice Strong. This dissent went on the broad ground that the storage of grain is not a public business or one for which a legislature has the power to fix rates. Nowhere in the dissenting opinion is it contended that in a public business where a legislature has the right to fix rates the amount or reasonableness of these rates can be reviewed by the court. On the contrary, Judge Field said in the course of his opinion:

If it be admitted that the legislature has any control over the compensation, the extent of that compensation becomes a mere matter of legislative discretion. . . . . The several instances mentioned by counsel in the argument, and by the court in its opinion, in which legislation has fixed the compensation which parties may receive for the use of their property and services, do not militate against the views I have expressed of the power of the state over the property of the citizen. They were mostly cases of public ferries, bridges, and turnpikes, of wharfingers, hackmen, and draymen, and of interest on money. In all these cases, except that of interest on money, which I shall presently notice, there was some special privilege granted by the state or municipality; and no one, I suppose, has ever contended that the state had not a right to prescribe the conditions upon which such privilege should be enjoyed.

At the October term of the Supreme Court, in 1876, when the opinion in Munn *vs.* Illinois was delivered, cases involving the validity of railway rates fixed by the legislatures of Iowa, Minnesota, and Wisconsin were also decided. Several of these cases involved the power of legislatures to fix conclusively the rates for public service under the Fourteenth Amendment, and in each case the court affirmed this power.

In Chicago, Burlington & Quincy Railroad Co. *vs.* Iowa,[2] maximum rates fixed for transportation by a statute of that state were contested on the ground, among others, that the rates fixed would take property of the railway without due process of law. Replying to

[2] 94 U. S. 155.

this contention the court in an opinion upholding the statute said through Chief Justice Waite:

In the absence of any legislative regulation upon the subject, the courts must decide for it, as they do for private persons, when controversies arise, what is reasonable. But when the legislature steps in and prescribes a maximum of charge, it operates upon this corporation the same as it does upon individuals engaged in a similar business.

In other words, the court decided that due process of law was satisfied when rates for public service were fixed by the legislature.

The next case, Peik *vs.* Chicago & North-Western Railway Co.,[3] was brought to restrain the enforcement of a law of Wisconsin that fixed maximum rates for passengers and freight. It was contended on the part of the railway security holders that the rates named in the statute would destroy the value of their securities, that the railway was entitled to collect reasonable compensation for its services, and that reasonable compensation was a question for the court and not for the legislature. Chief Justice Waite again delivered the opinion of the court, in which it was said, upholding the statute:

In Munn *vs.* Illinois, *supra*, p. 113, and Chicago, Burlington & Quincy Railroad Co. *vs.* Iowa, *supra*, p. 155, we decided that the state may limit the amount of charges by railroad companies for fares and freights, unless restrained by some contract in the charter, even though their income may have been pledged as security for the payment of obligations incurred upon the faith of the charter. So far this case is disposed of by those decisions. . . . . As to the claim that the courts must decide what is reasonable, and not the legislature. This is not new to this case. In has been fully considered in Munn *vs.* Illinois. Where property has been clothed with a public interest, the legislature may fix a limit to that which shall in law be reasonable for its use. This limit binds the courts as well as the people. If it has been improperly fixed, the legislature, not the courts, must be appealed to for the change.

In Chicago, Milwaukee & St. Paul Railroad Co. *vs.* Ackley[4] the court said, speaking through Chief Justice Waite:

The only question presented by this record is whether a railroad company in Wisconsin can recover for the transportation of property more than the maximum fixed by the act of March 11, 1874, by showing that the amount charged was no more than a reasonable compensation for the services rendered. . . . . But for goods actually carried, the limit of the recovery is that prescribed by the statute.

Two cases[5] involving railway rates under a statute of Minnesota

[3] 94 U. S. 164. [4] 94 U. S. 179. [5] 94 U. S. 180.

followed those just considered, and the court in brief opinions stated that they were covered by the rulings already made.

In Stone *vs.* Wisconsin,[6] which was decided in favor of a state statute fixing rates, the only question not covered by Chicago, etc., Railway Co. *vs.* Ackley, according to the court, related to the construction of a certain charter.

Justices Field and Strong dissented in each of the above railway cases, but gave no opinion until Stone *vs.* Wisconsin was reached, when Justice Field prepared an opinion in which Justice Strong concurred. In this opinion the dissent to this entire group of railway cases was put on the ground that the railway charters were contracts with the legislatures, which should protect the companies from state regulation of rates.

Besides Chief Justice Waite, the celebrated group of cases headed by Munn *vs.* Illinois was supported by Justices Clifford, Hunt, Bradley, Swayne, Davis, and Miller. The assertion by these judges of the power of states to fix conclusive rates for public service seems to have been as emphatic as any believer in local self-government could desire.

The doctrine of the Granger Cases, that a state may fix conclusive rates for local public service was reaffirmed in the case of Ruggles *vs.* Illinois,[7] where the validity of a law of that state providing a maximum fare per mile on railways was called in question. In the course of its opinion sustaining the law the Supreme Court said:

> This implies that, in the absence of direct legislation on the subject, the power of the directors over the rates is subject only to the common law limitation of reasonableness, for in the absence of a statute, or other appropriate indication of the legislative will, the common law forms part of the laws of the state to which the corporate by-laws must conform. But since, in the absence of some restraining contract, the state may establish a maximum of rates to be charged by railroad companies for the transportation of persons and property, it follows that, when a maximum is so established, that fixed by the directors must conform to its requirements, otherwise the by-laws will be repugnant to the laws.

Seven judges supported the majority opinion in this case, and two judges, Field and Harlan, delivered separate concurring opinions. Judge Harlan held that the charter of the railway in question was a contract that gave it the right to collect reasonable rates, but that the rates fixed by statute were not shown to be unreasonable. Judge Field

[6] 94 U. S. 181. [7] 108 U. S. 526.

held that the statutory rates had not been shown unreasonable, but did not state why he thought that they were bound to be reasonable.

By 1885 a fundamental change had taken place in the position of a portion of the court on the question of state power over rates for public service. This change was brought out by the case of Stone *vs.* Farmers' Loan & Trust Co.,[8] where an effort was made to enjoin the enforcement of rates under a Mississippi statute. The court through Chief Justice Waite affirmed the power of the state to fix rates and upheld the statute, but added:

> From what has been said, it is not to be inferred that this power of limitation or regulation is itself without limit. This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation. Under pretense of regulating fares and freights, the state cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of private property for public use without just compensation, or without due process of law. What would have this effect we need not now say, because no tariff has yet been fixed by the commission, and the statute of Mississippi expressly provides "that in all trials of cases brought for a violation of any tariff of charges, as fixed by the commission, it may be shown in defense that such tariff so fixed is unjust.

Thus was the underlying principle of the Granger Cases as to reasonable rates brought in question. Unlimited power of regulation like that affirmed in those cases may certainly be used to destroy and did in fact destroy much of the value of railway securities under the Granger Acts. It was said of the United States Bank by Chief Justice Marshall in M'Culloch *vs.* State of Maryland:[9]

> That the power of taxing it by the states may be exercised so as to destroy it, is too obvious to be denied.

The tax imposed by Congress on note issues of state banks after the close of the Civil War in the exercise of its power to regulate the currency, and upheld in Veazie Bank *vs.* Fenno,[10] certainly destroyed these issues completely. Of course, if the power to regulate is itself regulated by some other and higher power, the former may be held within any desired limits. The above quotation from the opinion in Stone *vs.* Farmers' Loan and Trust Co.[11] must mean, therefore, an assertion by the court of its power to review rates fixed by a state. Even the Granger Cases never decided that a railway must continue in business against its will under rates fixed by a state; it was open to the railway to go out of business. Neither did the Granger Cases decide

[8] 116 U. S. 307. [9] 4 Wheaton 316. [10] 8 Wall. 533. [11] 116 U. S. 307.

that the property used in a public service might be taken without due process of law, but rather that state regulation of rates for such service was due process of law. The power asserted by the court in the case under consideration must therefore relate to the review of the reasonableness or justice of rates fixed by a state. This meaning is made clear by the statement that:

> What would have this effect we need not now say, because no tariff has yet been fixed by the commission. . . . .

The opinion in the case under consideration was delivered by Chief Justic Waite who spoke in the Granger Cases, and was also supported by Justices Bradley, Miller, Woods, Matthews, and Gray, of whom Bradley and Miller took part in the Granger Cases. Justices Harlan and Field dissented, and Blatchford did not sit. The dissent of Harlan, J., went on the ground that the railway charters were contracts that permitted the companies to fix their own rates unless they were shown to be unreasonable.

In Dow *vs.* Beidelman[12] a statute of Arkansas that fixed a maximum fare of three cents per mile on railroads in that state was upheld by a unanimous court. It was shown in this case that the rates fixed by statute, on the basis of the existing traffic, would yield a net yearly income of less that 1.5 per cent. on the original cost of the road and only a little more than 2 per cent. on the bonded debt. The evidence did not show, however, how much the then owners of the railway had paid for it. Justice Gray said in delivering the opinion of the court:

> Without any proof of the sum invested by the reorganized corporation or its trustees, the court has no means, if it would under any circumstances have the power, of determining that the rate of three cents a mile fixed by the legislature is unreasonable.

The dictum above quoted from Stone *vs.* Farmers' Loan and Trust Co.,[13] as to limitations on the power of states to fix conclusive rates, was repeated with approval in the case under consideration.

In neither of these two cases was it open to members of the court who did not assent to this dictum, but who did agree with the decision, to dissent from the opinion, because the principle of the dictum was not acted on in either decision. The later of these two cases was decided by eight judges, Chief Justice Waite having died at Washington, March 23, 1888.

In Chicago, Milwaukee & St. Paul Railway Co. *vs.* Minnesota,[14] the dicta put forth in previous cases that the reasonableness of rates fixed

[12] 125 U. S. 680. [13] 116 U. S. 307. [14] 134 U. S. 418.

by a state is subject to review by the courts, was established by the force of a judicial decision. This case arose under a statute of Minnesota which authorized a commission to fix transportation rates. The commission reduced the rate for carrying milk between certain points from 3 cents to 2.5 cents per gallon, and the Minnesota courts refused to admit evidence offered by the railway that the latter rate was unreasonable, holding that under the statute the findings of the commission were conclusive. From this decision the railway appealed to the federal court on the ground that the denial of a judicial hearing as to the reasonableness of the rates would deprive it of property without due process of law. Mr. Justice Blatchford delivered the opinion of the court, holding the Minnesota statute void because it made the rates fixed by the commission conclusive. In the course of this opinion the court said:

> The question of the reasonableness of a rate of charge for transportation by a railroad company, involving, as it does, the element of reasonableness, both as regards the company and as regards the public, is eminently a question for judicial investigation, requiring due process of law for its determination. If the company is deprived of the power of charging reasonable rates for the use of its property, and such deprivation takes place in the absence of an investigation by judicial machinery, it is deprived of the lawful use of its property, and thus, in substance and effect, of the property itself, without due process of law, and in violation of the Constitution of the United States; and in so far as it is thus deprived, while other persons are permitted to receive reasonable profits upon their invested capital, the company is deprived of the equal protection of the laws.

Dissent from some of the judges who decided the Granger Cases was now due. This dissent could not properly have been delivered in the earlier cases where the power of the court to review rates fixed by a state had been asserted, because those assertions were mere dicta and were not involved in the decisions of the cases where they occurred.

In the course of a long dissenting opinion, concurred in by Justices Gray and Lamar, Justice Bradley said:

> I cannot agree to the decision of the court in this case. It practically overrules Munn *vs.* Illinois, 94 U. S. 113, and the several railroad cases that were decided at the same time. The governing principle of those cases was that the regulation and settlement of the fares of railroads and other public accommodations is a legislative prerogative and not a judicial one. This is a principle which I regard as of great importance. When a railroad company is chartered, it is for the purpose of performing a duty which belongs to the state itself. It is chartered as an agent of the state for furnishing

public accommodation. The state might build its railroads if it saw fit. It is its duty and its prerogative to provide means of intercommunication between one part of its territory and another. And this duty is devolved upon the legislative department. If the legislature commissions private parties, whether corporations or individuals, to perform this duty, it is its prerogative to fix the fares and freights which they may charge for their services. . . . . But it is said that all charges should be reasonable, and that none but reasonable charges can be exacted; and it is urged that what is a reasonable charge is a judicial question. On the contrary, it is pre-eminently a legislative one, involving considerations of policy as well as of remuneration; and is usually determined by the legislature, by fixing a maximum of charges in the charter of the company, or afterwards, if its hands are not tied by contract. If this maximum is not exceeded, the courts cannot interfere. . . . . Thus, the legislature either fixes the charges at rates which it deems reasonable, or merely declares that they shall be reasonable; and it is only in the latter case, where what is reasonable is left open, that the courts have jurisdiction of the subject. I repeat: when the legislature declares that the charges shall be reasonable, or, which is the same thing, allows the common-law rule to that effect to prevail, and leaves the matter there; then resort may be had to the courts to inquire judicially whether the charges are reasonable. Then, and not till then, is it a judicial question. But the legislature has the right, and it is its prerogative, if it chooses to exercise it, to declare what is reasonable.

This is just where I differ from the majority of the court. They say in effect, if not in terms, that the final tribunal of arbitrament is the judiciary; I say it is the legislature. I hold that it is a legislative question, not a judicial one, unless the legislature or the law (which is the same thing) has made it judicial, by prescribing the rule that the charges shall be reasonable, and leaving it there. It is always a delicate thing for the courts to make an issue with the legislative department of the government, and they should never do so if it is possible to avoid it. By the decision now made we declare, in effect, that the judiciary, and not the legislature, is the final arbiter in the regulation of fares and freights of railroads and the charges of other public accommodations. It is an assumption of authority on the part of the judiciary which, it seems to me, with all due deference to the judgment of my brethren, it has no right to make. . . . . It is complained that the decisions of the board are final and without appeal. So are the decisions of the courts in matters within their jurisdiction. There must be a final tribunal somewhere for deciding every question in the world. Injustice may take place in all tribunals. All human institutions are imperfect—courts as well as commissions and legislatures. Whatever tribunal has jurisdiction, its decisions are final and conclusive unless an appeal is given therefrom. The important question always is, what is the lawful tribunal for the particular case? In my judgment, in the present case, the proper tribunal was the legislature, or

the board of commissioners which it created for that purpose. . . . . It may be that our legislatures are invested with too much power, open, as they are, to influences so dangerous to the interests of individuals, corporations, and society. But such is the constitution of our republican form of government; and we are bound to abide by it until it can be corrected in a legitimate way. If our legislatures become too arbitrary in the exercise of their powers, the people have always a remedy in their hands; they may at any time restrain them by constitutional limitations.

This strong dissent, in 1889, gives a glimpse of the conflict that had been going on in the Supreme Court since the decision of the Granger Cases, in 1876. As far as can be seen from the line of decisions noted, only two of the seven judges who decided those cases ever receded from the position there taken that the court could not review the reasonableness of rates fixed by a legislature. Of these two judges, Waite indicated his change of view by the dictum above quoted from Stone *vs.* Farmers' Loan and Trust Co., and Miller concurred in the majority decision of the Minnesota case just considered, by a separate opinion.

As new judges came onto the Supreme Bench, the support given by the court to the principles of the Granger Cases grew less. In Chicago, etc., Railway Co. *vs.* Minnesota[15] the scales were turned and five justices—Fuller, Field, Harlan, Blatchford, and Brewer—supported the majority opinion. Of the nine judges who sat in the Granger Cases only Justices Field, Miller, and Bradley remained to take part in the case last decided, and of these three Justice Bradley alone adhered to the fundamental doctrine of the earlier decisions.

By Chicago, etc., Railway Co. *vs.* Minnesota[16] the Granger Cases were in large measure overruled. Due process of law was no longer to be found in rates fixed by states, but in decisions of the court as to what was reasonable. Under this decision the states may exercise as much or as little control over rates as the court sees fit to permit. In Munn *vs.* Illinois[17] the court said:

> The controlling fact is the power to regulate at all. If that exists, the right to establish the maximum of charge, as one of the means of regulation, is implied.

With equal force it may be said that assertion by the court of authority to review the reasonableness of rates fixed by legislatures opened the way for a great reduction in state powers. Since 1889, when the paramount authority of the court was established by a judi-

[15] 134 U. S. 418. [16] 134 U. S. 418. [17] 94 U. S. 113.

cial decision, suits to invalidate rates fixed by legislatures have multiplied and decisions have borne with increasing severity on state powers.

In Budd *vs.* New York, decided in 1892, the validity of a statute of that state was contested on the ground that rates fixed by it for elevating and storing grain were not within the state power to make and were unreasonable. Mr. Justice Blatchford in delivering the opinion of the court, supported the power of the state to regulate the business of storing grain and said:

> In the case before us, the records do not show that the charges fixed by the statute are unreasonable, or that property has been taken without due process of law, or that there has been any denial of the equal protection of the laws; even if under any circumstances we could determine that the maximum rate fixed by the legislature was unreasonable.

It was also said in this opinion, referring to Chicago, etc., Railway Co. *vs.* Minnesota:

> What was said in the opinion in 134 U. S., as to the question of the reasonableness of the rate of charge being one for judicial investigation, had no reference to a case where the rates are prescribed directly by the legislature.

This statement was *obiter dicta*, pure and simple, as the rates in Budd *vs.* New York were not shown to be unreasonable, was in direct conflict with the language of the Minnesota case and no support for it can be found in later decisions. Morever, the three dissenting judges in the Minnesota case certainly understood the decision there to apply to rates fixed directly by a legislature as well as to those fixed by a commission. It is to be noted that the Minnesota statute itself, as construed by the Supreme Court of that state, was declared invalid by the United States Supreme Court, and not merely the rates fixed under the statute. This statute evidently failed because it denied the right of the courts to investigate the reasonableness of rates fixed under it.

As to reasonable rates Budd *vs.* New York[18] simply shows that their unreasonableness must be proved before the court will hold them void on that ground. Justices Brewer, Field, and Brown dissented in this case.

Brass *vs.* North Dakota[19] involved the validity of a statute of that state that fixed rates for storing grain. The case turned on the power of the legislature to fix rates at all, rather than on the reasonableness of the rates actually fixed. The court upheld the statute, and said in its opinion, delivered by Justice Shiras:

[18] 143 U. S. 517. [19] 153 U. S. 391.

We are limited by this record to the questions whether the legislature of North Dakota in regulating by a general law the business and charges of public warehousemen engaged in elevating and storing grain for profit, denies to the plaintiff in error the equal protection of the laws or deprives him of his property without due process of law, and whether such statutory regulations amount to a regulation of commerce between the states.

Justices Brewer, Field, Jackson, and White dissented, leaving only Fuller, C. J., and Justices Harlan, Gray, Brown, and Shiras to decide the case.

In Chicago & Grand Trunk Railway *vs.* Wellman,[20] decided a few months earlier than Budd *vs.* New York, the court upheld a law of Michigan regulating railway rates, and said:

> The legislature has power to fix rates, and the extent of judicial interference is protection against unreasonable rates. . . . . Surely before the courts are called upon to adjudge an act of the legislature fixing the maximum passenger rates for railroad companies to be unconstitutional, on the ground that its enforcement would prevent stockholders from receiving any dividends on their investments, or the bondholders any interest on their loans, they should be fully advised as to what is done with the receipts and earnings of the company; for if so advised, it might clearly appear that a prudent and honest management would, within the rates prescribed, secure to the bondholders their interest, and to the stockholders reasonable dividends.

The opinion delivered by Justice Brewer in this case clearly upholds the doctrine of Chicago, etc., Railway Co. *vs.* Minnesota, that the court has power to review the reasonableness of rates fixed by a legislature.

Reagan *vs.* Farmers Loan and Trust Co.[21] furnished another application of the same doctrine by restraining the railway commission of Texas from enforcing rates fixed under a statute of that state. The statute provided that rates fixed under it were to be deemed reasonable until finally found otherwise in a direct action, but enforcement of the rates fixed was enjoined before their reasonableness was determined by evidence, in spite of the language of the statute. In the opinion of the court, delivered by Justice Brewer, affirming the preliminary injunction and holding the rates unreasonable and void, it was said:

> Is there anything which detracts from the force of the general allegation that these rates are unjust and unreasonable? This clearly appears. The cost of this railroad property was $40,000,000; it cannot be replaced today for less than $25,000,000. There are $15,000,000 of mortgage bonds outstanding against it, and nearly $10,000,000 of stock. These bonds and stock

[20] 143 U. S. 339. [21] 154 U. S. 362.

represent money invested in the construction of this road. The owners of the stock have never received a dollar's worth of dividends in return for their investment. The road was thrown into the hands of a receiver for default in payment of the interest on the bonds. The earnings for the last three years prior to the establishment of these rates was insufficient to pay the operating expenses and the interest on the bonds. In order to make good the deficiency in interest the stockholders have put their hands in their pockets and advanced over a million of dollars. The supplies for the road have been purchased at as cheap a rate as possible. The officers and employees have been paid no more than is necessary to secure men of the skill and knowledge requisite to suitable operation of the road. By the voluntary action of the company the rate in cents per ton per mile has decreased in ten years from 2.03 to 1.30. The actual reduction by virtue of this tariff in the receipts during the six or eight months that it has been enforced amounts to over $150,000. Can it be that a tariff which under these circumstances has worked such results to the parties whose money built this road is other than unjust or unreasonable?

It may be suggested that the decision in this case rested on the provision of the Texas statute that suits might be brought to determine the reasonableness of rates fixed by the commission. This view cannot be maintained, however, because the statute expressly provided that rates so fixed should be deemed reasonable until finally found otherwise in an action brought by the dissatisfied party, and that in such actions "the burden of proof shall rest upon the plaintiff, who must show by clear and satisfactory evidence that the rates, regulations (etc.), complained of are unreasonable and unjust." The case in which the injunction restraining the commission from enforcing the rates in question was granted came up to the Supreme Court on demurrer by the commissioners and the attorney-general to the complaint of the Trust Co., so that there was no hearing on the merits as the statute required. In deciding the case the court went on the broad ground that it had power to determine whether rates fixed by states were reasonable. This was shown by the statement in the course of the opinion

> that no legislation of a State, as to the mode of proceeding in its own courts, can abridge or modify the powers existing in the Federal courts sitting as courts of equity.

And also that there could be

> no doubt of their power and duty to enquire whether a body of rates prescribed by a legislature or a commission is unjust and unreasonable, and such as to work a practical destruction to rights of property, and if found so to be, to restrain its operation.

The court modified the force of its decision by the statement that

It is unnecessary to decide, and we do not wish to be understood as laying down as an absolute rule, that in every case a failure to produce some profit to those who have invested their money in the building of a road is conclusive that the tariff is unjust and unreasonable. . . . . There may be circumstances which would justify such a tariff; there may have been extravagance and needless expenditure of money; there may be waste in the management of the road; enormous salaries, unjust discrimination as between individual shippers, resulting in general loss. The construction may have been at a time when material and labor were at the highest price, so that the actual cost far exceeds the present value; the road may have been unwisely built, in localities where there is no sufficient business to sustain a road. Doubtless, too, there are many other matters affecting the rights of the community in which the road is built as well as the rights of those who have built the road.

Evidently this case decides only that under the circumstances stated a road is entitled to earn interest on its bonds and something for its stockholders, besides paying necessary operating expenses. How much the return to stockholders may be is not decided. As no evidence was taken, it does not appear how the court knew that the failure of the road to earn "some profit" was not due to some of the "matters" named above.

In the case just considered and also in that of St. Louis & San Francisco Railway *vs.* Gill,[22] decided during the same year, 1894, there was no dissent, but the entire court concurred in the opinion. These two cases present interesting comparisons, as the railway company in each sought protection from a law for the regulation of rates, and each alleged in its pleadings that the rates fixed for transportation would yield no profit on the invested capital, and each case was decided on demurrer.

The case of St. Louis & Santa Fé Railway *vs.* Gill came up under a law of Arkansas, passed in 1887, that fixed a maximum rate of three cents per mile for the transportation of passengers on railroads of that state, and named a penalty of $300 payable to any passenger from whom an overcharge was exacted. Gill was charged five cents per mile and obtained a verdict in the state courts against the railway for the amount of the penalty. The railway took the case to the Supreme Court on the ground that the rate fixed by statute would result in a taking of its property without due process of law. Proof was offered for the railway that on the branch where Gill was charged five cents per mile the actual cost to the railway was 3.3 cents per mile for each passenger carried; that this branch line had never earned more than

[22] 156 U. S. 649.

1 per cent. annually above actual operating expenses on the capital stock that had been paid in cash and invested in this line. These offers of proof were not accepted, and the demurrer of Gill to the pleadings of the railway was sustained by the court in an opinion sustaining the validity of the rates fixed by the Arkansas law. The opinion, delivered by Justice Shiras, took occasion to assert the power claimed in previous cases, by saying:

This court has declared, in several cases, that there is a remedy in the courts for relief against legislation establishing a tariff of rates which is so unreasonable as to practically destroy the value of property of companies engaged in the carrying business, and that especially may the courts of the United States treat such a question as a judicial one, and hold such acts of legislation to be in conflict with the Constitution of the United States, as depriving the companies of their property without due process of law, and as depriving them of the equal protection of the laws.

The line of railway on which Gill was charged five cents per mile, and to which the offers of proof seemed to refer, extended from the northern boundary of Arkansas to Fayetteville in that state, and had formerly been owned by a separate company. Referring to these circumstances the court said:

In this state of facts we agree with the views of the supreme court of Arkansas, as disclosed in the opinion contained in the record, and which were to the effect that the correct test was as to the effect of the act on the defendant's entire line, and not upon that part which was formerly a part of one of the consolidating roads; the company cannot claim the right to earn a net profit from every mile, section, or other part into which the road might be divided.

Finally came the important statement that

Even if the evidence could be understood as applicable to the entire line in Arkansas, there was no finding of the facts necessary to justify the courts in overthrowing the statutory rates as unreasonable, but that, on the contrary, the company's case depended on allegations admitted by the demurrer of a party who, in no adequate sense, represented the public.

This case seems to represent an effort of the court to stay the tendency of former decisions toward the destruction of state power in the regulation of rates. It is hard to see why the rates on a distinct line of railway should not be regulated according to the investment and expense of operation on that line, even though the line in question forms only a part of a large consolidated system.

The demurrer by a private litigant as a barrier to judicial annulment of rates fixed by legislatures did not stand the test of the next

case on the subject that came before the court, namely, Covington, etc., Turnpike Co. *vs.* Sandford.[23] By an act of the Kentucky legislature in 1890 the rate of toll that might be charged on the turnpike owned by the company just named was reduced. Sandford obtained an injunction in the state courts which required the turnpike company to charge no more than the statutory rate of toll. From this injunction the company sought relief in the Supreme Court on the ground that the reduction in rates would take its property without due process of law. In the decision of the Supreme Court, prepared by Justice Harlan, it was said that the answer of the company

> alleged that the receipts for the several preceding years had not admitted of dividends greater than 4 per cent. on the par value of the company's stock; that the act of 1890 reduced the tolls 50 per cent. below those allowed by the act of 1865; and that such reduction would so diminish the income of the company that it could not maintain its road, meet its ordinary expenses, and earn any dividends whatever for stockholders.
>
> These allegations were sufficiently full as to the facts necessary to be pleaded, and fairly raised for judicial determination the question — assuming the facts stated to be true — whether the act of 1890 was in derogation of the company's constitutional rights. It made a *prima facie* case of the invalidity of that statute.

This opinion reversed the action of the Kentucky courts which granted the injunction, though no evidence was before the court that the allegations of the company in its pleadings were true. Sandford acted in this case simply as a private person who wished to use the turnpike, and the admissions of his demurrer to the pleadings of the company were held sufficient ground on which to overturn the statute. The previous decision in the Gill case that a statute cannot be held invalid on the demurrer of a private person was thus overruled. Admitting the statements in the pleadings of the company in this Sandford case to be true, the case simply follows the rule previously laid down that rates cannot be reduced to a point where they allow no return on the investment above operating expenses. This case, decided in 1896, was concurred in by the entire court. Though not required for the decision of the case, it was stated in the course of the opinion that

> It cannot be said that a corporation is entitled, as of right, and without reference to the interests of the public, to realize a given per cent upon its capital stock. When the question arises whether the legislature has exceeded its

[23] 164 U. S. 578.

constitutional power in prescribing rates to be charged by a corporation controlling a public highway, stockholders are not the only persons whose rights or interests are to be considered. . . . . If a corporation cannot maintain such a highway and earn dividends for stockholders, it is a misfortune for it and them which the constitution does not require to be remedied by imposing unjust burdens upon the public.

These dicta indicate that there might be instances due to unwise investments, or perhaps to competition, where a corporation would not be protected in a right to earn any return on its investment.

The next case to come before the court involving the reasonableness of rates fixed by state authority was that of Smyth *vs.* Ames, decided in 1898.[24] A notable difference between this case and those that had preceded it lay in the fact that the decision of the court was based on evidence taken at the trial as to the investments and earnings of the railways involved, instead of on allegations or admissions of parties to the suit. The case arose under a Nebraska statute of 1893, that prescribed rates for the transportation of freight on railways in that state, by a prayer on the part of persons interested in these railways for an injunction to prevent enforcement of these rates. In a unanimous opinion, delivered by Justice Harlan, the court said:

We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in such case.

We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth. But even upon this basis, and determining the probable effect of the act of 1893 by ascertaining what could have been its effect if it had been in operation during the three years immediately preceding its passage, we perceive no ground on the record for reversing the decree of the circuit court. On the contrary, we are of opinion that as to most of the companies in question there would have been, under

[24] 169 U. S. 466.

such rates as were established by the act of 1893, an actual loss in each of the years ending June 30, 1891, 1892, and 1893; and that, in the exceptional cases above stated, when two of the companies would have earned something above operating expenses, in particular years, the receipts or gains, above operating expenses, would have been too small to affect the general conclusion that the act, if enforced, would have deprived each of the railroad companies involved in these suits of the just compensation secured to them by the Constitution.

The injunction confirmed by the court in this case enjoined the Nebraska Board of Transportation and the attorney-general of the state from taking any steps to enforce the rates fixed by the act of 1893. It should be noted that the court based its decision on the income that would have been derived from the local freight actually carried by the railways during the fiscal years of 1891, 1892, and 1893, ending June 30, at the rates prescribed by the act which took effect August 1, 1893. This takes no account of the fact that a decrease in rates may be followed by an increase in traffic, especially as to heavy farm produce which it may not pay to move at all if the freight is more than a very moderate figure.

The most important rule laid down by the case is that the basis of calculations as to reasonable rates of a corporation "must be the fair value of the property being used by it for the convenience of the public."

This statement with others in the opinion, appears to limit "fair value" to that of the physical property and to exclude franchise valuations. Unless the value of the physical property employed in a public service and the actual cost of performing that service are to be taken as the basis of rate calculations, the amount of rates would appear to depend mainly on the arbitrary opinion of the company or legislature making them. Though the majority of the railways in Nebraska could have made nothing on their investments under the rates prescribed by the act of 1893, as the court understood the evidence, yet the opinion states that two companies could have earned "something" above operating expenses. Reference to the evidence on which the court relied, and which was repeated in the opinion, shows that this something amounted to 1.99, 4.06, 6.84, and 10.63 per cent. annually on the values of the railways. Unless the court thought that this rate of net earnings was so small as to amount to a taking of property without due process, it does not appear why the Nebraska act was unconstitutional as to the roads making this rate. According to dicta in the Sandford

case above cited, an act might be constitutional as to some roads and unconstitutional as to the others.

A still later case in the Supreme Court, that of Cutting *vs.* Goddard, decided in 1901, goes farther than any of the foregoing in its limitation of state powers. This case arose under a Kansas statute of 1897 that fixed charges for handling live stock at stock yards where more than a certain amount of business was done, and affected the yards at Kansas City. Petitions were filed asking that the attorney-general of Kansas be restrained from enforcing the statute as to these yards, and, after hearings in which evidence was taken as to the value of the yards and the annual earnings, the injunction was granted. In the course of the unanimous opinion of the court, delivered by Justice Brewer, it was said:

> If the rates prescribed by the Kansas statue for yarding and feeding stock had been in force during the year 1896, the income of the stock-yards company would have been reduced that year $300,651.77, leaving a net income of $289,916.96. This would have yielded a return of 5.3 per cent. on the value of the property used for stock-yard purposes, as fixed by the master.

The actual net income of the company during 1896, as found by the master and the court below, was $590,558.73, and the value of its property in the stock yards was $5,388,003.25, so that its net income during that year amounted to nearly 11 per cent. on its investment. After pointing out the liability of a person engaged in the operation of public stock yards to some legislative regulation, the court proceeded to define the limits of such regulation, and said:

> The question is not how much he makes out of his volume of business, but whether in each particular transaction the charge is an unreasonable exaction for the services rendered. He has a right to do business. He has a right to charge for each separate service that which is reasonable compensation therefor, and the legislature may not deny him such reasonable compensation, and may not interfere simply because out of the multitude of his transactions the amount of his profits is large.

These reasons for the decision of the court are negative in character. They tell us that it matters not that profits are large if rates are only reasonable. But what are reasonable rates? How are they to be determined if considerations as to investments and profits are put aside? If reasonable rates do not imply reasonable profits, where is the amount of charge to stop short of what the person receiving the service can be induced to pay?

A quarter of a century has transferred the test of reasonable rates from the opinions of state legislatures to the opinion of the Supreme Court. In the Granger Cases the court denied its right to interfere with local rates fixed by legislatures, even when these rates were so low as to destroy all profits. This doctrine, after various adverse dicta, was fully repudiated by the case of Chicago, etc., Railway Co. *vs.* Minnesota, decided in 1889, thirteen years after the Granger Cases. From that date to 1896, when Covington, etc., *vs.* Sandford was decided, the court went no farther than to hold that legislative rates must afford some income above operating expenses. Another step was taken the following year, when the court held in Smyth *vs.* Ames that rates which permitted a net profit of as much as 10.63 per cent. on one road, but nothing on others, could not be enforced as to either.

Finally, in 1901, comes the decision, in Cutting *vs.* Goddard, that rates which yield a profit of 10.9 per cent. on the investment are not unreasonable, and that rates which would reduce this profit to 5.3 per cent. are unconstitutional.

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